Tax Supported
New Issue

San Antonio, Texas

Ratings

New Issues

General Improvement Bonds, Series 2004 .... AA+
Combination Tax and Revenue Certificates of Obligation, Series 2004 .... AA+
Taxable General Improvement Refunding Bonds, Series 2004........ AA+

Outstanding Debt

General Obligation Bonds .... AA+
Certificates of Obligation.................... AA+

Rating Outlook .... Stable

Analysts

José Hernandez
1 512 322-5317
jose.hernandez@fitchratings.com

José Acosta
1 512 322-5324
jose.acosta@fitchratings.com

Issuer Contact

Milo Nitschke
Director of Finance
1 210 207-8620

See page 2 for New Issue Details.

Outlook

The 'AA+' rating reflects San Antonio's favorable overall economic activity and diversification, solid financial practices and adequate recent results, and very well-managed direct debt position. The city's financial position has stabilized after flat revenue growth caused substantial operating pressure on the general fund in fiscal 2002. Fiscal challenges remain for the next fiscal period but are considered manageable. The three primary sectors of the local economy are medical and health care, the military, and tourism. San Antonio has proactively addressed base realignment concerns through the ongoing redevelopment of one site and innovative measures to diminish the risk of further base closures. The Rating Outlook is Stable.

Rating Considerations

San Antonio is the third largest city in the state and ninth largest in the U.S., according to census information, with an estimated population of 1,266,700 for 2003. The city is located in the south central area of the state, approximately 150 miles north, as well as east, of the border with Mexico and 75 miles south of the state capital of Austin. Prominent industries in the local economy are domestic and international trade, convention and tourism, military and government employment, medical and health care, financial, and telecommunications. Its proximity and cultural similarities to Mexico provide a favorable environment for international business relationships.

After posting a substantial operating deficit in the previous fiscal year, financial reserves rebounded in fiscal 2003 due, in part, to a nearly $39 million increase in electric utility revenue transfers to the general fund. Equal to 14% of its electric utility's (City Public Service, or CPS) annual gross revenues, electric sales spiked during this period due to rising fuel costs exacerbated by a four-month repair of one reactor at the South Texas Nuclear Project, part of which is owned by CPS. Due to a record $204 million in CPS transfers, fiscal 2003 undesignated reserves increased to $41.5 million, or 7.0% of expenditures and transfers out. Despite sales tax receipts that were 6.0% less than budgeted, fiscal 2003 operating results nearly restored the undesignated general fund reserves to previous levels after the substantial drawdown in fiscal 2002.

Due to various revenue enhancements and expenditure reductions, including the elimination of 137 civilian positions, the city was able to adopt a balanced budget for fiscal 2004, funded with no change to the city's total property tax rate. Revenue growth assumptions are on budget through the first quarter of fiscal 2004, including a projected 2.8% increase in sales taxes. Preliminary fiscal 2005 projections point to a modest operating deficit, but unresolved policy issues regarding employee health benefits, workers compensation, and civilian compensation increases may substantially increase the budget gap.

March 11, 2004

New Issue Details

$34,685,000 General Improvement Bonds (GOs), Series 2004, $30,710,000 Combination Tax and Revenue Certificates of Obligation (COs), Series 2004, and $12,795,000 Taxable General Improvement Refunding Bonds (Taxable GOs), Series 2004, are scheduled to sell on March 16 via negotiation to a syndicate led by First Southwest Company. Coastal Securities and Estrada Hinojosa & Co. are serving as co-financial advisors to the city. Dated March 1, 2004, the GOs mature Feb. 1, 2008–2024, the COs mature Feb. 1, 2005–2024, and the taxable GOs mature Feb. 1, 2005–2016. All of the current offerings maturing on and after Feb. 1, 2014 are subject to optional redemption at par plus accrued interest on Feb. 1, 2013.

Security: The GOs are payable from ad valorem taxes levied annually against all taxable property within the city up to the constitutional limit of $2.50 per $100 of taxable assessed valuation. The COs are additionally secured by a lien on and pledge of revenues from the city's municipal parks system (not to exceed $1,000).

Purpose: GO proceeds will be used to finance the construction of general improvements to the city; CO proceeds will be used to finance the cost of implementing the new Enterprise Resource Management system, for various public improvements, and to pay costs of issuance. Taxable GO proceeds will be used to refund a portion of the city's outstanding debt used to finance certain parking facilities.

However, the city council and staff are exploring all options to minimize the budgetary stress, including benefit plan changes.

The city's finances have benefited from solid growth in its taxable assessed valuation (TAV), increasing by an average of more than 7.0% since fiscal 1998. Fiscal 2004 TAV increased by more than $3 billion, the majority of which ($1.6 billion) was due to new construction. The city's top 10 taxpayers comprise a modest 5.3% of total appraised value. In an effort to spur investment in the city's southern sector, the city recently annexed 57 square miles on a limited purpose basis (increasing its size by almost 15%) and rezoned an impressive 4,600 properties to facilitate smart growth land use. The area includes the site of the new Toyota Tundra plant, which broke ground on its $800 million facility in October 2003. Although the city does selectively grant property tax abatements, no such abatement was requested or granted for the Toyota facility, although the city did provide, in tandem with the state, some short-term financial incentives and infrastructure improvements.

The direct debt burden of the city is moderate. Annual general obligation (GO) bond and certificate of obligation (CO) issuance is expected to support the capital program through fiscal 2006. A GO referendum for $115 million was approved in November 2003. Due to the city's strong debt management plan, the debt service portion of the tax rate is not expected to require significant adjustment to accommodate future borrowing. The principal payout rate for property tax-backed debt is above average at almost 70% in 10 years. The overall debt burden is considered high, primarily due to public school debt; however, adjusting for state support for school debt service mitigates these levels considerably.

To provide more flexibility in contracting with private operators of its parking facilities, the city is issuing taxable refunding bonds for the portion of outstanding debt that originally financed the construction of these facilities. The city's next bond issue is scheduled for November 2005 for $73 million in GO bonds and $12 million in COs. The city is also considering refinancing a portion of its $177 million hotel occupancy tax (HOT) bonds this summer as part of its plan to create extra capacity for a possible headquarters hotel for its recently expanded convention center. An upcoming charter election in May includes referendums to change city council members' term limits to allow two consecutive three-year terms and to create an ethics review board.

■ Strengths

- Continued economic growth and diversification, although at a slower pace.
- Competent administrative staff and fiscal stewardship.
- Moderate and very well-managed direct debt position, with affordable future borrowing plans.

■ Risks

- Service delivery pressures and spending requirements associated with growth.
- Uncertain long-term ability of city-owned electric utility to continue payments to the general fund due to industry deregulation.
- Challenge of securing long-term water supplies, although a funding mechanism is now in place.

Debt

The city's direct debt profile is extremely well-positioned to accommodate borrowing needs over the next few years. In November 2003, voters approved five GO bond propositions totaling $115 million. Debt proceeds will be used to fund street and pedestrian ($29 million), drainage ($19 million), library ($4 million), parks and recreation ($27 million), and public health and safety ($35 million) improvements. Combined with approximately $46 million in CO financing, the new authorization is expected to address the city's capital needs through fiscal 2006 with minimal impact on the property tax rate.

Through its multiyear debt management model, which utilizes very conservative assumptions for TAV growth and property tax collections, the maximum property tax rate requirement for this capital program is projected to be $0.2420 per $100 of TAV in fiscal 2011. The current interest and sinking fund rate is $0.2115 per $100 of TAV. Only 0.5% annual growth in existing appraised values and 1% annual growth in new improvements are considered in the financial model, which is well below the 7% TAV annual growth since fiscal 1998.

Debt Statistics

($000)

New Issues (This Issuance):	
General Improvement Bonds	34,685
Combination Tax and Revenue COs	30,710
Taxable General Improvement Refunding Bonds	12,795
Outstanding Debt:	
General Improvement Bonds	669,728
Certificates of Obligation	192,670
Sales Tax Commercial Paper Notes	13,400
Hotel Occupancy Tax Bonds	177,347
Municipal Property Corp. Lease Revenue	13,420
Starbright Industrial Development Corp. Bonds	24,685
Capital Leases	10,244
Total Direct Debt	1,179,684
Less: Self-Supporting Debt	14,210
Less: Refunding	12,795
Net Direct Debt	1,152,679
Total Overlapping Debt*	1,448,049
Overall Net Debt	2,600,728

Debt Ratios

Net Direct Debt per Capita ($)**	910
As % of Taxable Assessed Valuation†	2.6
Overall Net Debt per Capita ($)**	2,053
As % of Taxable Assessed Valuation†	5.8

*Adjusted to reflect state support for local school district debt. **Population: 1,266,700 (2003 estimate). †Taxable assessed valuation: $44,536,796,000 (fiscal 2004). COs – Certificates of obligation.

Also considered in the model are annexations, including last year's limited purpose annexation of 57 square miles just to the south of the city, including the site of the Toyota project.

Amortization of property tax-supported debt is very rapid, with nearly 70% retired within 10 years. The city's GO and CO debt has an average life of just under eight years at a reported effective interest rate of 4.6%. Also, the debt service fund balance ended fiscal 2003 with nearly $88 million in reserve, which represented almost 73% of debt service expenditures for the year. City staff continually monitors its debt portfolio for refunding opportunities and is contemplating a $20 million debt defeasance. The debt service fund balance is anticipated to be reduced gradually to about $30 million.

The direct debt burden is moderate at $910 per capita and 2.6% of TAV. Eliminating HOT debt from direct debt results in ratios of $770 and 2.2%, respectively. Later this year, the city likely will pursue a HOT refunding of the $177 million outstanding that was issued for the convention center expansion, potentially seeking to provide debt capacity for a headquarters hotel. Pension obligation bonds for public safety funds are also being considered, to prospectively prefund future required contributions, as well as make up any actuarial deficiencies, if necessary.

The overall debt burden is moderate on a per capita basis at $2,761 and high as a ratio of TAV at 7.9%. The majority of overlapping debt is for area public schools. However, incorporating state support for school district debt service adjusts levels to $2,053 and 5.8%, respectively.

Finances

The city's financial position has stabilized after flat revenue growth caused substantial operating pressure on the city's general fund in fiscal 2002. Declining by almost $30.0 million, undesignated reserves fell to a level equal to 3.4% of expenditures and transfers out during this fiscal period. However, including fiscal 2002's reserve for revenue loss of $23.2 million increases the fund balance cushion to $42.9 million, or 7.3%. The reserve for revenue loss equaled 4% of operating expenditures and transfers out in fiscal 2002, and the city plans to increase it to 5.0%.

Although property tax revenues increased by $13.8 million, or 10.9%, in fiscal 2002, payments from CPS declined precipitously by $17.3 million

General Fund Financial Summary
($000, Audited Fiscal Years Ended Sept. 30)

	1999	2000	2001	2002	2003
Revenues	472,309	511,369	543,445	545,853	596,151
Expenditures	426,984	457,510	501,547	517,454	521,696
Net Change	45,325	53,859	41,898	28,399	74,455
Transfers In	15,208	16,325	19,043	11,198	13,121
Transfers Out	(64,442)	(61,575)	(70,445)	(73,343)	(68,386)
Net Income	(3,909)	8,609	(9,504)	(33,746)	19,190
Total Fund Balance	84,536	93,145	96,198	62,452	81,642
As % of Expenditures and Transfers Out	17.2	17.9	16.8	10.6	13.8
Unreserved Fund Balance	75,672	80,993	86,658	53,658	74,410
As % of Expenditures and Transfers Out	15.4	15.6	15.2	9.1	12.6
Undesignated Fund Balance	66,964	50,306	49,437	19,797	41,484
As % of Expenditures and Transfers Out	13.6	9.7	8.6	3.4	7.0

from the fiscal 2001 amount, offsetting all other revenue increases. A major component of the city's general fund revenues, CPS annually transfers 14% of its gross revenues for general operations. The exceptionally hot summer of 2001, which caused high electricity usage for air conditioning, and the spike in natural gas prices for heating both led to higher utility revenues, while the temperate summer of 2002 did not produce the revenues conservatively budgeted for. Fitch Ratings recently affirmed its 'AA+' rating on the utility system debt of CPS.

Conversely, a nearly $39.0 million increase in CPS transfers in fiscal 2003 enabled the city's financial reserves to rebound substantially. Due to a record $204.0 million in CPS transfers, fiscal 2003 undesignated reserves increased to $41.5 million, or 7.0% of expenditures and transfers out. The addition of the $23.2 million reserve for revenue loss increases the city's fund balance cushion to $64.7 million, or 10.9%. Despite sales tax receipts that were 6% less than budgeted, fiscal 2003 operating results nearly restored the reserves to previous levels after the substantial drawdown in fiscal 2002. CPS gross revenues spiked during this period due to rising fuel costs exacerbated by a four-month repair of one reactor at the South Texas Nuclear Project, part of which is owned by CPS.

Although city officials initially identified a $35.0 million budget gap for fiscal 2004, $41.9 million in additional revenues and $15.4 million in expenditure reductions enabled the adoption of a balanced budget funded with no change to the city's total property tax rate of $0.579 per $100 of TAV. CPS transfers are conservatively projected at $178 million, well below recent record amounts and less than the fiscal 2001 level.

Revenue growth assumptions are on budget through the first quarter of fiscal 2004, including a projected 2.8% increase in sales taxes. For the fiscal 2004 budget, property tax, sales tax, and CPS payments comprise 75.2% of general fund revenues. The city continues to receive 14% of CPS revenues. While CPS is no longer as dominant a revenue source for the general fund as in prior years, it remains the largest at 27.8%. Of expenditures, public safety, consisting of police, fire, and emergency medical services, consumes 56.2% of available general fund resources.

Preliminary fiscal 2005 projections point to a modest operating deficit of $4.6 million, but unresolved policy issues regarding employee health benefits, workers compensation, and civilian compensation increases may substantially increase the budget gap to $30.7 million. However, the city council and staff are exploring all options to minimize the budgetary stress, including benefit plan changes.

■ Economy

Health care and bioscience, hospitality, and government employment, including the military, are the leading sectors of the local economy. The health care and bioscience industry is the largest segment for the city. With an estimated $11.1 billion economic impact in 2001, health care provided 14% of all jobs in the San Antonio area and employed more than 98,000 with an annual payroll of nearly $3.5 billion. The major components of this sector include the 900-acre South Texas Medical Center, with 10 major hospitals and the University of Texas Health Science Center at San Antonio; military health care, consisting of three major military hospitals; and biomedical research and development, including the Texas Research Park.

Growth Indicators
(Fiscal Years Ending Sept. 30)

Fiscal Year	TAV ($000)	% Change	Sales Taxes ($000)	% Change
1994	22,480,585	—	92,669	—
1995	24,309,875	8.1	97,667	5.4
1996	26,793,725	10.2	103,033	5.5
1997	28,320,799	5.7	110,034	6.8
1998	29,422,285	3.9	118,992	8.1
1999	31,253,551	6.2	126,473	6.3
2000	33,315,479	6.6	133,816	5.8
2001	36,033,321	8.2	136,811	2.2
2002	39,587,584	9.9	140,084	2.4
2003	41,535,547	4.9	138,962	(0.8)
2004	44,536,796	7.2	142,900*	2.8

*Budgeted amount. TAV – Taxable assessed valuation.

The hospitality industry, consisting of conventions and tourism, is a significant component of the city's economy, with an estimated annual economic impact of $7.2 billion and more than 86,000 employees. During 2002, San Antonio attracted nearly 20 million visitors, which resulted in direct spending of $4.8 billion in the city. To capture larger conventions, the convention center has undergone significant expansion and renovation. The project has been completed, giving the center 400,000 square feet of contiguous space. Plans also are being developed for the establishment of a convention center headquarters hotel. To address downtown parking needs for the hotel, the city parking system expanded the parking facility at the convention center. Additionally, to support both commerce and visitor industries, the municipal airport has completed a reengineering study and master plan to implement cost efficiencies, enhance service delivery, and undertake terminal and gate expansion and airfield improvement projects.

Another principal component of the local economy is the military, whose presence is represented by Lackland Air Force Base (AFB), Randolph AFB, and Fort Sam Houston U.S. Army Base. The property of a fourth installation, Brooks AFB, was transferred to the city as part of the Brooks-City Base Project, which is designed to lessen the operating costs of facility maintenance for the Air Force, thereby reducing the possibility of base closure in the next round of deliberations scheduled for 2005.

The Air Logistics Center at Kelly AFB was closed in July 2001, which led to the establishment of the Greater Kelly Development Authority (GKDA). The goal of the GKDA is to create 21,000 jobs by 2006 at KellyUSA, the new business and industrial park, including the 12,000 lost as a result of realignment. To date, the GKDA has successfully leased eight million square feet of space through the execution of 74 leases and attracted numerous companies, including Boeing Co., Lockheed Martin Corp., Chromalloy Gas Turbine Corporation, Standard Aero, General Dynamics, General Electric Co., and Pratt & Whitney. An additional 2.4 million square feet of space has been leased back to the Air Force for its continued needs. These efforts have retained 7,400 military personnel and created more than 5,200 new commercial jobs at KellyUSA. The next phases of development at KellyUSA will focus on establishing a port to serve international cargo, rail accessibility for inland port distribution, and expanding aviation maintenance, repair, and overhaul operations. A recent development affecting Fort Sam Houston is the announced relocation of the U.S. Army South from Puerto Rico, bringing approximately 500 new jobs with an annual economic impact of $200 million.

From an employment and unemployment standpoint, San Antonio and the surrounding area have been faring well. The latest unemployment figures available, for December 2003, equal unemployment rates of 5.4% for city residents and 4.8% for the metropolitan statistical area. The corresponding rates for the state and nation are 5.8% and 5.4%, respectively. The civilian labor force has been growing modestly at about 1.2% annually over the past three years, while employment growth has averaged about 1.5% annually for the same period.

STANDARD &POOR'S | RATINGSDIRECT

Return to Regular Format

Research:

San Antonio, Texas; Tax Secured, General Obligation

Publication date: 11-Mar-2004
Credit Analyst: Horacio Aldrete-Sanchez, Dallas (1) 214-871-1426; Theodore Chapman, Dallas (1) 214-871-1401

Credit Profile

US$12.795 mil taxable gen imp rfdg bnds ser 2004 dtd 03/01/2004 due 02/01/2016	AA+
Sale date: 16-MAR-2004	
US$30.71 mil comb tax and rev certs of oblig ser 2004 dtd 03/01/2004 due 02/01/2024	AA+
Sale date: 16-MAR-2004	
US$34.685 mil gen imp bnds ser 2004 dtd 03/01/2004 due 02/01/2024	AA+
Sale date: 16-MAR-2004	

AFFIRMED	
$921.686 mil. San Antonio	AA+

OUTLOOK:	STABLE

Rationale

Standard & Poor's Ratings Services assigned its 'AA+' rating, and stable outlook, to San Antonio, Texas' series 2004 taxable general improvement refunding bonds, series 2004 general improvement bonds, and series 2004 combination tax and revenue certificates of obligation.

The rating reflects the city's:

- Continued strong economy,
- Strong management with a comprehensive long-term program,
- Strong financial performance and position, and
- Moderately high debt burden with manageable capital needs.

The city's full faith and credit pledge secures the bonds and certificates of obligation.

San Antonio, with about 1.2 million residents, is Bexar County's seat and the nation's ninth-largest city. The designation of San Antonio as the site for a new Toyota Motor Corp. truck manufacturing facility, which is scheduled to be complete by the end of 2005, has brought substantial growth in the south portion of the San Antonio MSA. The plant should generate about 2,100 jobs and a total capital investment of roughly $800 million from Toyota. Assessed valuation (AV) growth regained strength in fiscal 2004, increasing by 7.2% over the prior year compared with a more modest increase of 4.9% in fiscal 2003. Total AV is now more than $44 billion. The residential and services and trade sectors continue to experience the strongest growth. The medical and biomedical industries now account for the largest part of the city's economy; they contributed an estimated $11.9 billion to the area as a whole in 2002. Expansions continue at South Texas Medical Center, which is the city's leading employer with nearly 29,000 employees. Government, specifically the military, remains a large component of the economy with five military bases in the city. In September 2003, the U.S. Army relocated its Southern Command Center to Fort Sam Houston from Puerto Rico, which created about 500 new jobs and an annual overall economic effect of roughly $200 million. In addition, efforts to privatize Kelly Air Force Base, which officially closed as a military installation in July 2001, continue to result in a slight net gain of jobs. The city also worked with Brooks Air Force Base to create Brooks City-Base, which is a collaborative effort between the city and the U.S. Air Force to retain jobs at Brooks by improving the facility's effectiveness. Unemployment in San Antonio, which has decreased to about 4.8%, remains below state and national levels. San Antonio's management policies and controls are very strong and include a comprehensive long-term capital program, as well as several transparency and accountability initiatives.

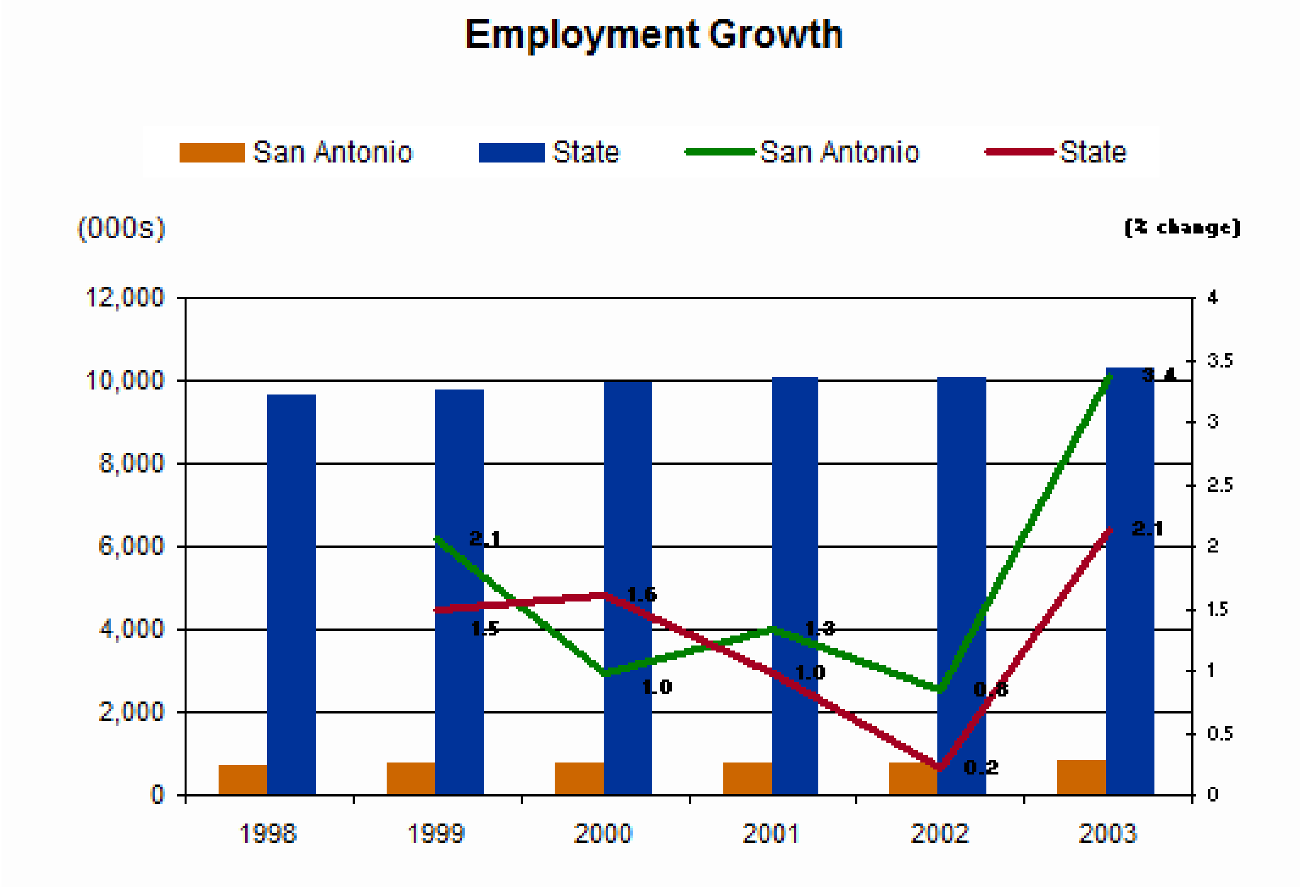
Following a deficit in fiscal 2002 that reduced the general fund balance to $55.0 million, San Antonio's financial performance improved significantly in fiscal 2003 with a $19.2 million operating surplus that restored the general fund balance to $81.6 million, or 14.2% of expenditures. The increase in the general fund balance was mainly the result of increased utility revenues from the city's share of city public service revenues and expenditure-containment measures. The city's fiscal 2004 budget is balanced. First quarter results are in-line with budgeted figures. The city continues to substantially exceed its goal of maintaining at least 5% of expenditures in the general fund, and $23 million of general fund reserves dedicated only to potential revenue declines provides additional flexibility; these reserve funds did not decline during fiscal 2002.

Overall net debt is high at roughly $2,549 per capita and high at more than 7% of market value. To some extent, these figures are elevated because they include the city's overlapping debt; overlapping debt is substantially comprised of school district debt, which receives significant support for debt service payments from the state's instructional facilities allotment program. In November 2003, the electorate approved a $115 million bond package to finance street and drainage improvements, parks and recreation facilities, improvements to the city's library system, and public health and safety facilities. This issuance of general improvement bonds is the first installment of that authorization. Management expects to issue a second installment of roughly $73.0 million in November 2005 and a final installment of roughly $7.2 million in November 2006.

Outlook

The stable outlook reflects the expectation that city management will continue to take the necessary actions to keep its budget balanced and that the city will continue to work to build reserves.

Chart 1



Economy

San Antonio is in south-central Texas, about 75 miles south of Austin, Texas and 150 miles north of the Mexican border. According to U.S. Census estimates for 2002, San Antonio is the nation's ninth largest city and the state's third largest. Although military and tourism have long been the driving forces in the city's economy, medical and biomedical companies are now the leading force, contributing an estimated $11.9 billion to the area's economy. The city has worked hard to build this component of its economy, which is evidenced by South Texas Medical Center's status as its leading employer. In all, the medical and biomedical fields account for about 106,000 jobs, or about 13% of the city's total employment. Despite the slowing economy and cutbacks of some employers, the city added about 26,000 jobs overall during 2003. Although wealth levels remain below the national average, they have consistently increased at a faster rate than the nation's levels. Growth in median household effective buying income from 1998-2002 reached 16.0% compared with the state's 10.4% and the nation's 5.4%. As a result, median household effective buying income is now at 99% of the nation's average, up from 89% in 1998. To support this upward trend in income growth, management has focused its economic development efforts to attracting industries in the biotechnology and health care, aerospace, telecommunications, IT, logistics and transportation, tourism, and automotive manufacturing sectors. Management estimates that total employment in these targeted industries will be about 275,000.

The city's property tax base is diversified: The 10 leading property taxpayers account for about 5% of total AV. H.E. Butt Grocery Co., the leading taxpayer, accounts for just 1.2% of total AV. Tourism and convention traffic continue to be strong. Hotel room nights have increased by a cumulative 12% over the past five years.

San Antonio's access to Mexico promotes strong international trade and tourism, creating further economic diversity.

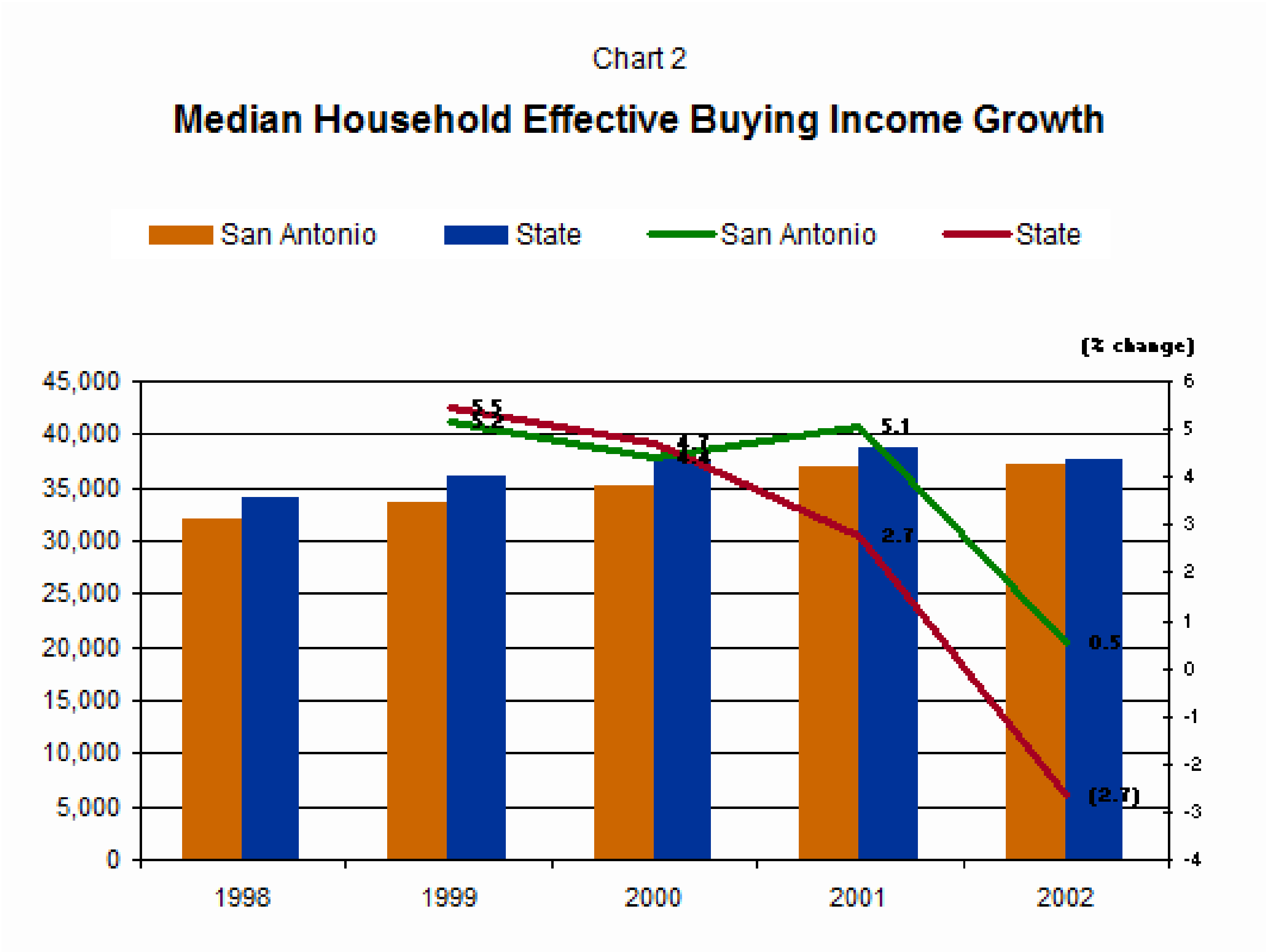
Government, specifically the military, continues to be a large component of the economy with five military bases in the city. Although Kelly Air Force Base officially closed as a military installation in July 2001, the city has worked at privatizing the base to prevent job losses. To date, 7,400 military jobs have been retained and 5,200 private sector jobs have been created. The city's goal is to create 21,000 jobs there by 2006, which would more than offset the estimated 12,000 jobs lost due to the base closing. Boeing Co. and Lockheed Martin Corp. are the leading employers at the Kelly installation, and city management expects them to spur further privatization and allow the retention of several aircraft repair operations. Total capital investment in this project has reached $191 million: $172 million of which has come from private investors. Subsequent phases of the Kelly-USA initiative include the development of a Class A business park with rail, air, and highway access and an estimated investment of $364 million in capital projects. City management expects this second phase of development to generate an additional 6,400 jobs and increase Kelly's economic effect on the local economy to $4.3 billion annually.

Similarly, San Antonio is working with Brooks Air Force Base to retain jobs there should future base closures be considered nationally. In July 2002, Brooks Air Force Base transferred ownership of all its land to the city. Part of the city's involvement includes the development of Brooks Technology & Business Park, where the U.S. Air Force will be the city's major tenant; the development of additional health services and biotechnology companies are also planned. Brooks City-Base is the only project of its kind in the nation. In the summer of 2003, the University of Texas at San Antonio opened a bio-processing training center at Brooks City-Base. In addition, Brooks City-Base has lease agreements with nine tenants; and the facility has been designated as a center for homeland security and city and county emergency operations.

In September 2003, the U.S. Army designated Fort Sam Houston in San Antonio as the new location for its Southern Command Center, creating about 500 jobs and an annual economic effect of roughly $200 million. In light of the upcoming Base Realignment and Closure round scheduled for 2005, city management has established a task force to implement a strategy to avoid base closures.

San Antonio won its bid for a new Toyota truck plant to be built on land south of the downtown area. The plant is scheduled to begin operations at the end of 2005. The city's economy will benefit from various aspects of the project, including roughly $800 million in capital investment from Toyota. The city expects about 2,100 construction jobs to be created by this project. Toyota projects the plant will produce 150,000 units of its Tundra truck annually at full operation. City management expects the project to create about 2,000 manufacturing jobs, as well as an additional 5,300 spin-off jobs in the area. The city recently issued contract revenue bonds through its Starbright Industrial Development Corp. to fund land acquisition and other costs associated with the project; the city will pay debt service on the bonds solely through revenues it pledges from the funds it receives from city public services. The city will create a three-year limited-purpose district for the site with the expectation that it will annex this land at the end of that period. The city is also planning a new site for Texas A&M University as part of its Southside Initiative.

To encourage the redevelopment of San Antonio's inner-city neighborhoods, management has implemented eight neighborhood commercial revitalization programs, which have attracted an estimated $54 million in private investment and 1,741 new jobs.



Finances

San Antonio's financial performance remains strong. In fiscal 2003, the city had an ample $19.2 million surplus, which restored, in part, a $33.9 million decrease in the unreserved general fund balance from fiscal 2002. The city's fiscal year-end 2003 $74.4 million unreserved general fund balance accounted for a healthy 13% of operating expenditures, which substantially exceeded the city's goal of maintaining at least 5% of expenditures in the fund. A significant 23% increase, or $38.9 million, in city public service payments to San Antonio accounted for much of the city's revenue growth in fiscal 2003. In addition, cost-containment measures provided the city with additional flexibility to achieve a year-end operating surplus. For fiscal 2004, San Antonio expects a balanced budget, including $34.1 million in additional revenues and a total of $12.5 million in expenditure reductions. First-quarter revenue and expenditure trends are in-line with the budget. Current fiscal 2005 projections estimate a roughly $30.8 million general fund revenue shortfall, which the city plans to address through additional expenditure adjustments.

The general fund continues to rely on city public service revenues, which account for about 30% of total general fund revenues. While city public services have moved into a deregulated environment, concerns are limited or mitigated by its favorable and competitive position. The city's fiscal 2003 sales tax revenues were slightly below the fiscal 2002 level. The city budgeted a 2.8% increase in sales tax revenues for fiscal 2004, which management expects will be achieved, especially since first-quarter collections are up by 3.9% over the first quarter of fiscal 2003.